In the Supreme Court of the United States

OCTOBER TERM 1944.

No. 342.

In the Matter of
THE HIGBEE COMPANY, *Debtor* } Bankruptcy No. 36,119.

ROBERT R. YOUNG,
Petitioner,

vs.

THE HIGBEE COMPANY,
WILLIAM W. BOAG and
J. F. POTTS,
Respondents.

REPLY BRIEF OF PETITIONER.

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Authorities.

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REPLY BRIEF OF PETITIONER.

Comments regarding the reply brief filed by Respondent Potts are appropriate in five particulars.

I.

AS TO ALLEGED INACCURACIES IN PETITIONER'S BRIEF.

The brief of Respondent J. F. Potts claims generally that Petitioner's original brief is inaccurate and misleading. A careful reading of the brief, however, discloses that the *only* specific charge of this character pertains to the "Questions Presented" on page 4 of Petitioner's original brief. Question No. 1 reads as follows:

> "1. After Potts and Boag had represented to the Court and to the Higbee preferred stockholders that they were acting as a committee in the interests of all preferred stockholders, can they thereafter accept and retain for themselves individually a $100,000 consider-

ation for permitting the dismissal of an appeal which they had taken from a decree confirming the Amended Plan of Reorganization of The Higbee Company?"

Respondents' Brief at pages 6 and 7 in commenting on the foregoing "Questions Presented" states as follows:

> "These questions *assume* that 'Potts and Boag had represented' that they were acting in a representative capacity.
>
> "That assumption is contrary to the explicit findings of fact made by the lower courts."

Turning to the record: At page 194, the Special Master on August 1, 1942 made the following finding:

> "Applicant (i.e. Potts) and Boag, *who had previously held themselves out as 'a committee organized solely for the benefit of preferred stockholders,'* dismissed their appeal pursuant to an arrangement with Charles L. Bradley and John P. Murphy by which they sold their First Preferred Stock, 260 shares of which applicant held legal title to 250 shares, for $115,000; which stock had a par value of $26,000 and a market value of considerably less." (Emphasis added.)

Question No. 1 on page 4 of Petitioner's original brief is strictly in accordance with this finding and assumes nothing contrary thereto. It is also substantiated by the pleadings and briefs filed by Potts, and the letter sent to stockholders by Potts under the letter-head "Independent Preferred Stockholders' Committee of The Higbee Company" (R. 172).

II.

AS TO THE FINDING OF FACT THAT POTTS AND BOAG WERE ACTING SOLELY IN THEIR OWN INTEREST.

The courts below have found that Potts and Boag were acting only in their own interest in appealing from the order confirming the Higbee plan of reorganization. Therefore, Respondents argue that they need not account for the proceeds of the sale of the appeal.

Petitioner does not seek a review of this finding. It is abundantly clear that Potts and Boag were acting only in their own selfish interests when they "sold" their appeal, retained the proceeds, and deprived other stockholders of an adjudication of the issues they had raised. It does not follow, however, that Potts and Boag are relieved of the duty to account, because:

First, Respondents are liable here because they *purported* to act in the interest of all stockholders. They *ostensibly* represented stockholders generally and led the stockholders to believe accordingly. That they were actually acting for themselves does not relieve them of the natural consequences of the fiduciary relationship which they openly assumed.

Second, irrespective of their numerous statements and representations, Respondents are liable here because of the nature of the objections which they asserted. Had they prevailed in their appeal, all preferred stockholders would have benefited. Under these circumstances the formalities of the pleadings are immaterial. The right of appeal from the order approving the plan belonged to the entire class. To permit such an appeal to be compromised for the enrichment of only a few members of the class would violate one of the fundamental purposes of the bankruptcy act—the avoidance of preferential treatment among security holders of equal rank.[1] This Court in *Sprague vs. Ticonic National Bank*, 307 U. S. 161, swept aside contentions by that respondent that the titles and formal designations employed in the litigation should control its essential character. Petitioner Sprague had successfully litigated on her own behalf rights under a trust agreement, and by doing so

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[1] See Bankruptcy Act Chapter X, Sec. 197 requiring the judge to classify stockholders "according to the nature of their respective * * * stock" and Sec. 216 dealing with plans of reorganization and provisions thereof altering or modifying the rights of "stockholders generally or some class of them."

she established the rights of all others similarly situated. In holding that she was entitled to an allowance of fees for her attorney, this Court said:

> "Whether one professes to sue representatively or formally makes a fund available for others may, of course, be a relevant circumstance in making the fund liable for his costs in producing it. But when such a fund is for all practical purposes created for the benefit of others, the formalities of the litigation—the absence of an avowed class suit or the creation of a fund, as it were, through *stare decisis* rather than through a decree—hardly touch the power of equity in doing justice as between a party and the beneficiaries of his litigation. As in much else that pertains to equitable jurisdiction, individualization in the exercise of a discretionary power will alone retain equity as a living system and save it from sterility."

Indeed, Respondent Potts knew that his activities were in the interest of all stockholders when, despite the "sale" of his appeal, he filed an application for fees and testified (R. 187), "Anything that we[2] accomplished, of course, would inure to the benefit of all of them. We couldn't prevent that."

At page 26 of Respondents' brief it is stated, "* * * the *only* persons who could have received the benefits of the appeal were the appellants themselves." Respondent reasons that because other stockholders had either accepted or not opposed the Higbee plan they would not receive the benefits which a successful prosecution of the appeal would have provided. This is not good bankruptcy law. If a plan of reorganization is held to be unfair, then it is unfair to security holders who have approved it as well as those who have opposed it, and a subsequent modification of the plan will benefit all. The argument contained in

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[2] The record at this point contains the word "he." It is obvious, however, that this is in error and the word should be "we."

the brief is directly contrary to the testimony of Respondent Potts quoted above. The case of *Bank vs. Flershem*, 290 U. S. 504, cited as authority by the Respondent, was not a bankruptcy case. It involved a receiver's judicial sale which was set aside at the instance of a minority creditor after the majority had collaborated in an effort to treat unfairly an uncooperative minority by means of a sale for less than the property was worth. The case is not authority for the proposition stated by Respondent that consent to a plan is binding before confirmation so that the consenting stockholder will not be entitled to more favorable treatment later provided by amendment.

Respondent, at pages 1, 8, 14, 20, 24 and 25 of his brief, asserts that *all* of the preferred stockholders of Higbee, except Potts and Boag individually, had accepted the Higbee plan of reorganization at the time Potts and Boag filed their appeal from the order of confirmation. If by this Respondent means that Potts and Boag were the only ones actively opposing the plan, then Petitioner does not disagree. If, however, Respondent Potts is seeking to convey the impression to this Court that each and every preferred stockholder of Higbee affirmatively filed a written acceptance of the Higbee plan, then the statements contained in the brief are untrue to the knowledge of Respondent Potts.

Respondent cites in support of the allegations contained in his brief two remarks by Judge Jones (R. 221 and 252), in neither of which was the question of the percentage of consenting shareholders in issue, and in both of which the District Judge was merely referring to the acceptances of the plan by the requisite percentage of preferred stockholders and the apparent acquiescence in the order confirming the plan by all shareholders except Potts and Boag who were the only ones who filed notices of appeal. A substantial number of preferred stockholders did not affirmatively file written consent to the plan.

III.

AS TO THE MOTIVES OF BRADLEY AND MURPHY IN PURCHASING THE POTTS AND BOAG STOCK.

It is claimed that Potts and Boag must be exonerated because Bradley and Murphy were motivated in their purchase by circumstances which arose in litigation between Young and Bradley and Murphy. Briefly the facts are as follows:

A—Young had sued George Ball (a) for violation of the Securities and Exchange Act of 1934 charging wrongful manipulation of stock, and (b) for breach of numerous warranties in an original contract of sale.

B—On March 2, 1942, settlement was effected and a corporation of which Young was a minority stockholder acquired a note of Bradley and Murphy and declared the same due and payable.

C—Bradley and Murphy in order to raise the money removed the Potts and Boag litigation.

These matters are all entirely irrelevant to the question of whether Potts and Boag violated the duties they had assumed in favor of the preferred stockholders. No action by any individual or group of individuals (barring express approval of their conduct by all preferred stockholders) could give Potts and Boag justification for their otherwise wrongful conduct. The activities of Young in some other litigation, not presently before this Court, could neither excuse Potts and Boag, nor deprive the preferred stockholders generally of their right to an accounting.

Although the activities of Young are not involved in this case, one may well contrast the utter disregard of the interests of the preferred stockholders demonstrated by Potts and Boag when they "sold" their appeal, with the action of Young disclosed by this record. Respondent Potts testified as to Young's position with respect to the dis-

missal of the Potts and Boag appeal in the event Young should succeed to the Bradley-Murphy position (R. 30):

"Q. Up to that time though you had had no discussion of the basis upon which the appeal was to be dismissed or—

A. Well, not in detail. However, Mr. Purcell, I think, did suggest that Mr. Young might be willing to make some concessions to the stockholders in reducing the amount to be received on the junior debt and take more common stock in lieu thereof. I don't recall at this time any other suggestions about terms or conditions under which the appeal would be dismissed."

Again at page 189 Potts testified:

"Q. Were there any other people interested in buying this stock at the time that you sold it to Mr. Bradley and to Mr. Murphy?

A. No; I don't think so.

Q. Mr. Young wasn't interested?

A. Apparently not."

* * * * *

"Q. He didn't offer you anything to go on with the appeal, did he?

A. No * * *."

Furthermore, prior to the "sale" of the appeal, Petitioner had advised Potts that in the event a compromise could be reached, "whereby some of the junior debt would be foregone in lieu of common stock," that Potts "would be entitled to file an application for compensation in the reorganization proceeding" (R. 47).

Thus the basis of discussion between Young and Potts concerning the conduct of the litigation was in accordance with legitimate and proper bankruptcy practices.

IV.

AS TO THE EFFECT OF THE DECISION OF THE CIRCUIT COURT OF APPEALS PERMITTING DISMISSAL OF THE APPEAL.

It is urged that the dismissal of the appeal resulted in a binding adjudication that Respondents Potts and Boag may keep the proceeds. This is a *non sequitur*. No question was presented to the Circuit Court of Appeals relating to the disposition of the proceeds of the stock sale and no adjudication on that question resulted from the dismissal. Furthermore, Potts and Boag having "sold" and assigned the appeal were not even parties to the proceedings before the Circuit Court at the time of its dismissal. The question there was whether Bradley and Murphy, being officers and directors of the Higbee Company, Debtor in possession, could purchase an appeal which challenged the fairness of the Higbee plan and the extent of their individual participation in the reorganization, and then dismiss the appeal thus purchased.

V.

AS TO THE POWER OF THE BANKRUPTCY COURT.

Respondent concedes (his brief page 22) that an abuse may exist in a situation of this character. It is claimed, however, that the courts are powerless to correct it and that complaints should be directed to the legislature.

The Bankruptcy Act, Chapter X, Section 212, provides in part as follows:

> "The judge may examine * * * any * * * committee or other authorization, by the terms of which an agent, attorney, * * * or committee purports to represent any

creditor or stockholder, may enforce an accounting thereunder * * *."[3]

Thus the bankruptcy court has specific authorization to "enforce an accounting" against an agent, attorney or committee which "purports to represent any creditor or stockholder." Even in the absence of such specific legislative authority, the bankruptcy court has inherent supervisory and disciplinary powers over attorneys and committees to compel the fair and proper administration of the act.

Respectfully submitted,

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[3] The entire section reads as follows:

"The judge may examine and disregard any provision of a deposit agreement, proxy, power or warrant of attorney, trust mortgage, trust indenture, or deed of trust, or committee or other authorization, by the terms of which an agent, attorney, indenture trustee, or committee purports to represent any creditor or stockholder, may enforce an accounting thereunder, may restrain the exercise of any power which he finds to be unfair or not consistent with public policy and may limit any claim or stock acquired by such person or committee in contemplation or in the course of the proceeding under this chapter to the actual consideration paid therefor."